IN THE
SUPREME COURT OF MISSOURI

SC87811

ABB C-E NUCLEAR POWER INC.,

Respondent,

v.

DIRECTOR OF REVENUE,

Appellant.

From the Administrative Hearing Commission of Missouri
The Honorable Karen A. Winn, Commissioner

SUBSTITUTE BRIEF OF APPELLANT DIRECTOR OF REVENUE

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JURISDICTIONAL STATEMENT

The Director of the Department of Revenue, State of Missouri, petitioned for judicial review of the July 19, 2005 Order and the June 23, 2005 Order Granting Summary Determination in Part entered by the Administrative Hearing Commission in *ABB C-E Nuclear Power Inc. v. Director of Revenue*, Case No. 04-0189RI (in Appendix at A1 and A22). The July 19 Order was the final decision on the complaint filed below by ABB C-E Nuclear Power. The Director filed a petition for review in the Court of Appeals, Western District, pursuant to Missouri Supreme Court Rule 100.02, and §§ 621.050 and 621.189, RSMo 2000. The petition comes directly to an appellate court pursuant to § 621.189, RSMo 2000.

The issue presented by the petition is whether the capital gain income generated by the § 338(h)(10) election was "business income" for Missouri income tax purposes, as "business income" is used in the three-factor apportionment method of the Multistate Tax Compact, § 32.200, Art. IV ¶1, 9, RSMo 2000. Having determined that it could not decide that issue without construing the statute – a revenue law (*see* Mo. Const. Art. V, § 3) – the Court of Appeals transferred the petition to this Court pursuant to Supreme Court Rule 83.02.

STATEMENT OF FACTS

This case arose from the sale by a multinational corporation of a subsidiary, ABB C-E Nuclear Power, Inc. ("ABB Nuclear") doing business in Missouri. The parties disagree whether the proceeds from that sale constitute "business income" subject to apportionment.

1. The companies.

The Administrative Hearing Commission ("AHC") somewhat inconsistently refers to the parent corporation of the family that included ABB Nuclear as ABB Ltd. and as ABB Participations, LLC. Administrative Hearing Commission Order Granting Summary Determination in Part, June 23, 2005 ("AHC Order"), Appendix ("App.") at A2, ¶¶ 1, 2.[1] For ease of reference, we will use "ABB Ltd." when referring specifically to the ultimate parent, and "ABB" when referring to the companies collectively.

The ABB group. ABB has described itself as a "leader in power and automation technologies that enable customers to improve performance while lowering environmental impact" (www.abb.com, viewed December 29, 2005) and claims: "As one of the world's leading engineering companies, we help our customers to use electrical power

[1] The June 23 Order, the substantive decision of the AHC, is found in the Administrative Record, Vol. I, beginning at p. 1631, and in the Appendix beginning at p. A1. We will cite to the paragraph number, if applicable, or to the appendix page. Cites to the Appendix are indicated by a page number beginning with "A."

effectively and to increase industrial productivity in a sustainable way." *Id*., viewed August 22, 2006. The AHC found that ABB was

> engaged in several distinct business segments through affiliated entities. One such business was the nuclear technology business, which consisted of engaging in nuclear plant and nuclear fuel-related supply; nuclear plant and nuclear fuel-related service and maintenance; and nuclear instrumentation and control . . . .

Id. ¶ 2. That is a verbatim restatement of a statement made in an affidavit by Julietta Guarino, Senior Vice President - Taxes, North America, of ABB Inc.[2] The only other information about the business of ABB put into the record by ABB Nuclear was the "Financial Review, ABB Group Annual Report 1999," Exhibit 5 to the Guarino affidavit.[3] Consistent with ABB's statements about its business, that Report shows that the business of ABB is grouped into power transmission and generation; automation; oil, gas, and petrochemicals; building technologies; and financial services. Exhibit 5 at 1. The family

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[2] The Guarino affidavit is in the Administrative Record at Vol. I, pp. 52-60. We will cite it here as "Guarino affidavit," with the pertinent paragraph number.

[3] Exhibit 5 to the Guarino affidavit is in the Administrative Record at Vol. I, pp. 103-162. We will cite it herein as "1999 Annual Report" and "Exhibit 5," and refer to internal page numbers.

of affiliated companies includes "a world leading supplier to the power generation sector," *id*. at 2, and "a leading industrial process automation company," *id*. at 3.

ABB C-E Nuclear. ABB Nuclear was a wholly-owned subsidiary of ABB Ltd., through wholly-owned intermediaries, ABB Holdings, Inc., and Asea Brown Boveri, Inc. *Id*. ¶ 1. ABB Nuclear engaged in the nuclear technology business. Though its principal domicile was in Connecticut, it had facilities in Hematite, Missouri. *Id*. ¶ 3, ¶ 27.

ABB Nuclear was the product of various acquisitions and mergers. Most recently, four companies merged into ABB Nuclear as of December 30, 1999. ¶ 26. But other companies – at least 11 – had merged into ABB Nuclear during the preceding decade. A7 ¶ 26; Respondent's Exhibit F, pp. 187-244.[4]

ABB Nuclear's immediate parent, Asea Brown Boveri, Inc., was a Delaware corporation located in Connecticut, that did not itself have activities in Missouri, and did not file Missouri tax returns. ¶ 15. ABB's nuclear technology business in other countries – Germany, France, Sweden, Belgium, and Korea – was owned and managed by other ABB Ltd. affiliates. *Id*. at A3. ¶¶ 4, 6-7.

Unfortunately, neither the Guarino affidavit nor the exhibits she attached adequately explain where ABB Nuclear and the other subsidiaries engaged in the nuclear technology business fit into the business of ABB. The 1999 Annual Report details the

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[4] Exhibit 5 begins in the Administrative Record in Vol. V at p. 894. The referenced pages are in Vol. VI, which begins with page 68 of Exhibit F.

place of operations or subsidiaries divested during that year. But it only generally notes the agreement to sell the nuclear technology businesses, which was expected to close "during 2000 and does not impact the 1999 financial statement." Exhibit 5 at 4. The Report does give a hint: the operations being sold "includ[ed] nuclear power plant control systems." *Id*. That suggests that the nuclear business was part of ABB's power or automation segments, all of which the company expected to grow in 2000 despite the sale of the nuclear technology operations. *Id*. at 1.

2. The sale.

In 1999, ABB decided to sell the nuclear technology business that it had assembled. ¶ 5. ABB sold the business to British Nuclear Fuels plc, an English company, for approximately $485 million on April 28, 2000. ¶ 8. The sale actually involved two separate transactions between ABB and British Nuclear Fuels: the purchase of ABB Nuclear's stock by BNFL Nuclear Services, Inc. for approximately $250,000,000, and the purchase by other affiliates of British Nuclear Fuels of the remaining stock and assets of ABB's nuclear business for approximately $235,000,000. A3 ¶ 8. On the ABB side, the sole signatory was ABB Handels-Und Verwaltungs AG, acting on behalf of all the affiliates of ABB Ltd. that were engaged in the nuclear business. A3-A4 ¶ 9. Asea Brown Boveri, ABB Nuclear's immediate parent in the ABB family, received all proceeds from the sale of ABB Nuclear stock. A4 ¶¶ 11-12.

3. Tax elections and returns.

At the time of the sale, the common parent of all ABB companies in the United States was ABB Participations, LLC. A5 ¶ 18. ABB Participations filed consolidated federal income tax returns that included ABB Nuclear, and that included the April 2000 sale. *Id*. ABB Participations elected to treat the sale of ABB Nuclear's stock as a deemed sale of assets under 26 U.S.C. § 338(h)(10). A5 ¶ 20. Thus the ABB Participations return included an attachment to Schedule D that showed a net gain of $203,828,492 to ABB Nuclear from the deemed sale. That gain, in turn, was netted against other gains and losses of the affiliated group. A5-A6 ¶ 21.

ABB Participations did not file a consolidated Missouri return covering the sale period. Rather, ABB Nuclear filed its own Missouri return for the year ending April 28, 2000. A6 ¶ 22. Because ABB Nuclear had not filed its own federal return, it "prepared a pro forma separate company federal return to determine the amount of federal taxable income to report on line 1 of the Missouri return." A6 ¶ 23. In that calculation, ABB Nuclear reported as non-business income the gain of $227,323,492 from the deemed sale of all of its assets pursuant to IRC § 338(h)(10). A6-A7 ¶ 23.

In some other states, ABB filed combined returns that included ABB Nuclear, rather than filing a separate ABB Nuclear return. A8 ¶ 30[a].[5]

[5] Because the AHC order actually has two paragraphs numbered "30," we refer to "30[a]" and "30[b]."

4. Missouri assessment, protest, and AHC decision.

The Director disagreed with ABB Nuclear's characterization of the gain from the deemed sale of its assets as "non-business income." A7 ¶ 24. Thus on October 22, 2002, the Director issued a notice of deficiency for 2000 for $2,615,578.28, including additions. *Id*. ABB Nuclear protested. *Id*. The Director's final decision dropped the additions, but still assessed $1,808,243.00 in tax, plus interest. A7 ¶ 25.

On February 13, 2004, ABB Nuclear sought relief in the AHC. *See* Petition, Administrative Record, Vol. I, at 1. On June 23, 2005, the AHC granted summary determination, in part, to ABB Nuclear. The AHC held that the proceeds of the sale of ABB Nuclear was not "business income" that ABB had to apportion. A21. Because the record left uncertain whether ABB Nuclear had made a payment and was entitled to a refund, the AHC ordered the parties to supplement the record. A21. Based on the parties' stipulation, on July 19, 2005, the AHC ordered a refund of $15,766. Administrative Record Vol. IX at 1653; A23.

The Director filed a timely petition for review by the Missouri Court of Appeals, Western District, which in turn transferred the petition to this Court.

POINT RELIED ON

The Administrative Hearing Commission erred in holding that the income received from the sale of ABB Nuclear is not subject to apportionment under § 32.200 because that income was "business income" as defined in § 32.200, Art. IV § 1(1) in that there was no basis in the record before the AHC on which to find that the sale of ABB Nuclear was not income from regular trade or business, *i.e.*, that it was not part and in furtherance of the businesses of providing technology and services to the power industry, or acquiring, consolidating, operating, and selling businesses.

Blessing/White, Inc. v. Zehnder, 768 N.E.2d 332 (Ill. App. 2002)

Texaco-Cities Service Co. v. McGaw, 695 N.E.2d 481 (Ill. App. 1998)

Crystal Communications, Inc. v. Department of Revenue, 2006 WL 1492459 at *9 (Ore. 2006)

Atlantic Richfield Co. v. Colorado, 601 P.2d 628, 631-32 (Colo. 1979)

§ 32.200, RSMo 2000

STANDARD OF REVIEW

This is an appeal from a decision by the Missouri Administrative Hearing Commission (AHC). The AHC's decisions are upheld when authorized by law and supported by competent and substantial evidence upon the record as a whole, and when they are not clearly contrary to the reasonable expectations of the General Assembly. *See Becker Elec. Co. v. Director of Revenue*, 749 S.W.2d 403, 405 (Mo. banc 1988); § 621.193, RSMo 2000. The appellate court, in essence, adopts the AHC's factual findings that are supported in the record. *See Concord Publ'g House v. Director of Revenue*, 916 S.W.2d 186, 189 (Mo. banc 1996).

As the taxpayer seeking relief, ABB Nuclear had the burden of proof before the AHC. *See* § 621.050.2, RSMo 2000.

ARGUMENT

The Administrative Hearing Commission erred in holding that the income received from the sale of ABB Nuclear is not subject to apportionment under § 32.200 because that income was "business income" as defined in § 32.200, Art. IV § 1(1) in that there was no basis in the record before the AHC on which to find that the sale of ABB Nuclear was not income from regular trade or business, *i.e.*, that it was not part and in furtherance of the businesses of providing technology and services to the power industry, or acquiring, consolidating, operating, and selling businesses.

1. "Business income."

This case arises under the Multistate Tax Compact, codified in Missouri at § 32.200, RSMo 2000. The Compact sets out a method of apportioning income of a multistate or multinational corporation among those jurisdictions constitutionally permitted to tax that income.[6] The process of apportionment then requires the calculation

[6] The Multistate Compact method of apportionment – sometimes called "three-factor" apportionment – is one of two methods provided by Missouri law. The other, "single-factor" apportionment, is codified in § 143.451, RSMo 2000. This Court last addressed "single-factor" apportionment in *Medicine Shoppe International, Inc. v. Director of Revenue*, 156 S.W.3d 333 (Mo. banc 2005). This Court last addressed "three-factor" apportionment in *Suburban Newspapers of Greater St. Louis, Inc. v. Director of*

of the "property factor" (Art. IV § 10), the "payroll factor" (Art. IV § 13), and the "sales factor" (Art. IV § 15) – hence the "three-factor" name. The Compact thus provides: "All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three." Art. IV § 9.

The dispute here is over what constitutes "business income" that is to be apportioned. The Compact defines "business income":

> (1) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

§ 32.200, Art. IV § 1(1).[7]

The question here is whether the income from the sale of ABB Nuclear stock (deemed to be a sale of ABB Nuclear assets) is "business income" under that statute. The

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Revenue, 975 S.W.2d 107 (Mo. banc1998).

[7] The Compact also defines the converse: "'Nonbusiness income' means all income other than business income." *Id*. Art. IV § 2(2).

Western District apparently concluded that resolving that disagreement will require the Court to construe the statutory definition of "business income." Thus we begin by addressing the proper construction of that definition.

Grammatically, the Compact's definition of "business income" has two clauses, which have led most courts to find within it two tests:

> The first, or "transactional" test, is reflected by the first clause of the definition stating that business income is "income arising from transactions and activity in the regular course of the taxpayer's trade or business.". . . The second, or "functional" test, is embodied in the second clause which reads that business income "includes income from tangible or intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business."

Blessing/White, Inc. v. Zehnder, 768 N.E.2d 332 (Ill. App. 2002), citing *Texaco-Cities Service Co. v. McGaw*, 695 N.E.2d 481 (Ill. App. 1998). *See also Crystal Communications, Inc. v. Department of Revenue*, 2006 WL 1492459 at *9 (Ore. 2006); *Atlantic Richfield Co. v. Colorado*, 601 P.2d 628, 631-32 (Colo. 1979).

Not all courts agree. In fact, "[c]ourts of the states that have adopted [similar] statutes . . . have split as to whether the functional test is a subset of the transactional test or whether it is a separate and independent basis for determining business income. Some

courts have held that the second part merely modifies or qualifies the first, and does not constitute a separate test." *Willamette Indus., Inc. v. Department of Revenue*, 15 P.2d 18, 21, n. 1 (Ore. 2000), citing *Ex Parte Uniroyal Tire Co.*, 779 So.2d 227 (2000).

The difficulty may have arisen from the use of "include." The first clause, covering income "from transactions and activity in the regular course of the taxpayer's trade or business," defines a particular subset of types of income to a corporation. The statute then says that "business income . . . includes" those described in the second clause, *i.e.*, "income from tangible or intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business." The courts disagree as to whether "includes" means that the first clause defines the universe and the second is merely an example of something within it, or whether the second clause supplements (though it overlaps) the first.

Most courts have interpreted "include" to sweep into the definition of "business income" some income that would not qualify under the first clause – that is, as a supplement to, not merely a subset of, "business income" as defined in the first clause, some have taken the alternative approach. *See Ex Parte Uniroyal*, 779 So.2d at 235-36; *In re Appeal of Chief Industries*, 875 P.2d 278, 282-83 (Kan. 1994). But reading the second clause to add nothing to the first ignores the actual language of the statute.

The first clause of the statute is transaction-based: it applies only to income produced by transactions made in the "regular course of business." The second clause, however, is property- or functionally-based. It applies to all assets that were an "integral

part" of the taxpayer's business, without regard to whether the actual use of those assets was in the "regular course" of such business. We discuss "transactional" and "functional" tests in more detail below, and then apply them.

But we note here that although this Court has not addressed the question of whether there are separate "functional" and "transactional" tests, it has twice considered the question of "income" under the Compact – first in *Dow Chemical Co. v. Director of Revenue*, 787 S.W.2d 276 (Mo. banc 1990). There the Court addressed whose "income" is to be categorized and apportioned. The Court held that the "business income" addressed in the Compact is the income of the entire corporate family:

> The Compact . . . takes into account the entire business income of a multistate enterprise to determine the income apportionable to Missouri for its taxation. The *business income* definition of the compact is a lean paraphrase for *income from a unitary business*. It gives effect to the concept that in the case of a multistate business enterprise, the contributions to income from functional integration [and other factors] are from the operation of the business as a whole, and so justify the taxation by a state of extraterritorial earnings by a fair apportionment formula.

Id. at 283 (brackets and emphasis in original).

The Court built on *Dow* in *Williams Companies, Inc. v. Director of Revenue*, 799

S.W.2d 602 (Mo. banc 1990). There, the AHC had found, first, "that management of funds that Williams Natural Gas Company loaned to its parent companies was not an integral part of its business." *Id*. at 606. The taxpayer then argued that because "management of funds was not an integral part of Williams Natural Gas business, the interest thereon cannot be business income." *Id*. The Court reversed the AHC, and in the process construed Art. IV § 1(1).

The Court held that determining whether income qualifies as "business income" requires a look at the business of the affiliated companies:

> Business income includes, but is not limited to, income from "integral parts" of a taxpayer's business, but that is not the *sine qua non* of business income under the Compact. Rather, the test is whether the income is "*income from a unitary business.*"

799 S.W.2d at 606, quoting *Dow*, 787 S.W.2d at 283 (emphasis in *Dow*), and citing *James v. International Telephone and Telegraph Corp.*, 654 S.W.2d 865, 868 (Mo. banc 1983). The application of the "business income" definition to the interest income was then simple:

> Appellants admit that Williams Natural Gas and the parent company payors were parts of a unitary business. The interest income was thus from a unitary business and may be apportioned under the Multistate Tax Compact.

799 S.W.2d at 606.

The income at issue in *Williams Companies* also included the "capital gain realized by Williams Pipeline Company on its sale of the Wood River Pipeline Company preferred shares." *Id*. at 607. The Court observed that the "undisputed facts adequately support the finding that Williams Pipeline Company's interest in Wood River Pipeline Company was a part of Williams Pipeline Company's unitary business." *Id*. Thus the sale of the shares was "apportionable under § 32.200." *Id*.

In reaching its conclusion as to Wood River, the Court cited language from *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983). There, the U.S. Supreme Court found it is unnecessary for the parent to assert much control over the subsidiary for it to be part of a "unitary business." *Id*. at 172. This Court began by quoting this statement from *Container Corp.*:

> When a corporation invests in a subsidiary that engages in the same line of work as itself, it becomes much more likely that one function of the investment is to make better use–either through economics of scale or through operational integration or sharing of expertise–of all the parent's existing business-related resources.

463 U.S. at 178, quoted in *Williams Companies*, 799 S.W.2d at 607. This Court then observed that in both *Container Corp*. and *Williams Companies*, "the parent company . . . exercised little control over the day-to-day activities of the subsidiaries." 799 S.W. 2d at

607. The Court then distinguished *Philip Morris, Inc. v. Director of Revenue*, 760 S.W.2d 888 (Mo. banc 1988), "in which there was no exchange of expertise or information and no purchases or sales between the entities." 799 S.W.2d at 607.

As construed by this Court, then, § 32.200 asks whether the income was that of a unitary business, and whether it came from the "regular trade or business operations" of that unitary business. The Director's regulations set out the same test:

> Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is business income or nonbusiness income is the identification of the transactions and activity which are the elements of a particular trade or business. In general all transactions and activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, a trade or business. . . .

12 CSR 10-2.075(4).

> Gain or loss from the sale, exchange or other

> disposition of real or tangible or intangible personal property constitutes business income if the property while owned by the taxpayer was used in the taxpayer's trade or business. . . .

12 CSR 10-2.075(5)(B).

Again, however, this Court has not yet considered whether Art. IV § 1(1) creates a single or two tests. It has merely emphasized the need to look at the entire "unitary" business in applying the "business income" definition. The language of the definition does contemplate two forms of "business income" – and the sale of ABB Nuclear's assets qualifies under both.

2. "Deemed" sale of assets.

Before more specifically addressing and applying the "transactional" and "functional" tests, we detour briefly to recognize that what ABB sold was not the assets of ABB Nuclear, but its stock in ABB Nuclear. ABB Nuclear may well still exist, with a different owner. Why, then, is there a question of "business income" at all, when the taxpayer who filed the return was ABB Nuclear, not ABB, and ABB, not ABB Nuclear, received the entire proceeds of the sale?

The tax liability arose because ABB chose for federal income tax purposes to treat the transaction not as a sale of stock, but as a sale of assets. Thus ABB Nuclear "was deemed for federal income tax purposes: (1) to have sold all of its assets while a member of the ABB Participations, LLC, selling consolidated group in a single transaction to a new corporation; (2) to have received the proceeds from the sale; and (3) to have

distributed such proceeds in a complete liquidation to its pre-acquisition shareholder, Asea Brown Boveri, Inc." A5 ¶ 20. The sale of ABB Nuclear's stock "is disregarded"; the sale is treated as a sale of assets for federal tax purposes by ABB Nuclear despite the AHC's finding that as a factual matter, ABB Nuclear did not "ever actually sell or otherwise dispose of all its assets in Missouri or elsewhere." A6 ¶¶ 21, 22.

ABB Nuclear has not disputed that once ABB made that election for federal tax purposes, it applied to ABB and ABB Nuclear for Missouri tax purposes. To the extent the proceeds from ABB's sale of ABB Nuclear stock is "business income," it is taxable in Missouri.

3. The business of ABB and ABB Nuclear.

Before addressing the "transactional" and "functional" tests, we must also look at what "business" is involved. Whatever the test for "business income," it requires consideration of the taxpayer's business, and the role that the assets sold played in that business. It thus requires a look at the record regarding that business. Here, of course, the "business" is undertaken by ABB (either ABB Ltd. or some entities in the ABB family), which assembled, operated, and sold ABB Nuclear (via the stock sale) and its other nuclear-related assets and received the proceeds, and by ABB Nuclear, whose assets were deemed sold and which filed the tax return.

We begin with the business of ABB. But the record is at best unclear with regard to ABB's business. In fact, the AHC made only a single, limited finding:

ABB Ltd., the top-tier holding company for the ABB

> group worldwide, engaged in several distinct business segments through affiliated entities. One such business was the nuclear technology business, which consisted of engaging in nuclear plant and nuclear fuel-related supply; nuclear plant and nuclear fuel-related service and maintenance; and nuclear instrumentation and control . . . .

A2 ¶ 3. In fact, it would be difficult to specifically identify the "trade or business" of ABB, given its global reach and diverse interests. That was particularly true in 1999 and 2000, when ABB was engaged in various "acquisitions and divestitures to further transform ABB," *i.e.*, to move "ABB's business portfolio towards providing knowledge and service solutions" and to "focus on activities with higher expected growth and synergy potential with other ABB businesses." ABB Annual Report 1999, Exhibit 5, at 2-3. ABB was not leaving the energy services field, of course; although it agreed in 1999 to sell its nuclear businesses, it simultaneously acquired other energy businesses. *See id*. at 3.

Unfortunately, there is little basis in the record for determining just what the business of ABB was. ABB relied solely on an affidavit of Julietta Guarino, Senior Vice President - Taxes, North America, of ABB Inc. In fact, the AHC's findings of fact largely quote from her affidavit. But her affidavit is extremely vague as to the business of ABB; she simply says (in language used verbatim by the AHC), "ABB Ltd., the top-tier holding company for the ABB group worldwide, engaged in several distinct business

segments through affiliated entities." Guarino affidavit ¶ 17. That statement and the resulting finding (A2 ¶ 2) are simply not enough to support a holding that the sale of ABB Nuclear was not in the regular course of ABB's business – the question posed to the AHC. ABB Nuclear thus failed to bear its burden of proof, and the decision of the AHC should be reversed.

As noted above, of course, there is some evidence in the record of the scope and content of ABB's business. That evidence suggests that ABB is engaged in at least two businesses, of which ABB Nuclear was a part. The first is providing technology and services in the power transmission and distribution industries. *See* ABB Group Annual Report 1999, Exhibit 5, at 1-4. The second is the acquisition, consolidation, and (sometimes) sale of companies in a particular business segment. But again, the parameters of ABB's business are unclear – except to say that it is much broader than the AHC decision contemplates.

We turn, then, to ABB Nuclear. The AHC did make findings as to ABB Nuclear's business. But even as to ABB Nuclear, there is a dearth of evidence in the record. Not surprisingly, then, those findings are quite conclusory – and suggest that ABB Nuclear operated as a division of ABB and not as an independent company with its own "regular course of business." The AHC found as to ABB:

> 2. ABB Ltd., the top-tier holding company for the ABB group worldwide, engaged in several distinct business segments through affiliated entities. One such business was

> the nuclear technology business, which consisted of engaging in nuclear plant and nuclear fuel-related supply; nuclear plant and nuclear fuel-related service and maintenance; and nuclear instrumentation and control ("the nuclear business").

The AHC then explained that ABB used its subsidiary ABB Nuclear to operate "the nuclear business" in the United States:

> 3. Petitioner was engaged in the nuclear business in the United States. Its principal place of business and commercial domicile were in Windsor, Connecticut. It had facilities in Newington, New Hampshire; Hematite, Missouri; and Chattanooga, Tennessee, as well as at other locations in the United States.

Perhaps most significant of the AHC's findings relates to the creation and composition of ABB Nuclear: "Four other companies merged into [ABB Nuclear] as of December 30, 1999 . . . . Other companies had been merged into [ABB Nuclear] in prior years." A7 ¶ 26. Actually, the record shows fifteen mergers over 10 years. Respondent's Exhibit F, pp. 187-244.

The AHC found that the acquisition and eventual disposition of the businesses placed in ABB Nuclear was done by ABB. *See* AHC ¶ 5-9. And again, the proceeds from the sale of ABB Nuclear flowed back to ABB. ¶ 11.

The business of ABB Nuclear, then, can be described in isolation as providing

services in the nuclear power industry. Or it can be described as merely part of ABB's "unitary business," a business that includes acquiring nuclear power businesses, assembling them into a viable service provider, providing nuclear-related services to clients in the power production sector, and, finally, selling the service provider.

4. Applying the "transactional" test.

As noted above, the first clause of the definition in Art. IV § 1(1) brings within "business income" any income "arising from transactions or activities in the regular course" of ABB's business. The dictionary definitions of these commonly used words give substance to the "transactional" test.

"Arise" means "to originate from a specified source," WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY (1993), p. 117, or "To originate; to stem (from). . . . To result (from)." BLACK'S LAW DICTIONARY (7th ed 1999), p. 102. There appears to be no dispute that the income at issue "arose" from the sale of ABB Nuclear.

A "transaction" is "An act, process, or instance of transacting," "Something that is transacted: as a: a business deal," WEBSTER'S, p. 2425-26, "The act or instance of conducting business or other dealings," or "Something performed or carried out; a business agreement or exchange." BLACK'S, p. 1503. Again, there is apparently no dispute; the sale of ABB Nuclear was a "transaction."

The disagreement here, as in many cases, arises in the limitation of the definition to income that arises from transactions in "the regular course of business." Webster's does not define the phrase, though it does define the critical term, "regular," variously as

"steady or uniform in course, practice, or occurrence," "not subject to unexplained or irrational variation," "steadily pursued," "orderly, methodical," "constituted, selected, conducted, made or otherwise handled in conformity with established or prescribed usages, rules, or discipline," and "normal, standard, correct." WEBSTER'S, p. 1913. Black's includes an entry for "regular course of business," BLACK'S, p. 1289, but then defines it as a synonym for "course of business," which in turn it defines as the "normal routine in managing a trade or business," *id*., p. 356.

Here, ABB (or ABB Nuclear, depending on your point of view) sold a line of business. There is no question but that prior to the sale, the assets used in that business were used in the "regular course" or both ABB's and ABB Nuclear's business. ABB Nuclear's argument is, in essence, that the fact that the sale involved an entire line of business (assuming, of course, that the "nuclear business" can logically be separated from ABB's power generation services business) removes the assets used in that line of business from the "regular course" of ABB Nuclear's business.

For a company such as ABB, there is nothing *ab*normal about selling a line of business. Indeed, buying and selling lines of business seems routine for ABB. That is shown not just by the acquisitions and mergers that resulted in ABB Nuclear, but by the other major transactions near the same time. During 1999, the ABB "Group made a number of other acquisitions and divestitures to further transform ABB." ABB Group Annual Report 1999, Exhibit 5, at 2. The changes were so significant that ABB "presented two columns of figures with the new ABB composition in the income and cash

flow statements." *Id*. "ABB acquired a leading industrial process automation company," "a company in Brazil for full-service activities and a valve and wellhead manufacturer in Argentina," and "an energy-related financial services company in the U.S." *Id*. at 3. At the same time, ABB did not just sell its nuclear technology assets, but "contributed most of its power generation businesses to a 50-50 joint company," and sold its share of a transportation company, "two cable businesses in Norway and Sweden and activities in uninterruptible power supply for computer and telecommunications systems," and its "gas chromotograph and mass spectrometer business." *Id*. at 4-5. Again, it appears from the record that buying and selling businesses is within the "regular course of" ABB's business.

Moreover, nothing in the AHC record suggests that ABB, despite its effort to shift its "business portfolio towards providing knowledge and service solutions" *id*. at 2-3, had left the business of serving the power generation and supply industry. That it sold its nuclear and some other assets to "focus on activities with higher expected growth and synergy potential with other ABB businesses, " *id*., does not support a holding that the sale of ABB Nuclear was not in the "regular course of business."

To support its holding, the AHC looks exclusively to the business of ABB Nuclear. But its findings of fact regarding ABB Nuclear's business – and the sketchy record on which they are based – simply do not provide enough support for its ultimate conclusion. The AHC never tackles the questions of acquisition and disposition of property. It recognizes that nuclear services businesses were assembled or consolidated

into ABB Nuclear. Assembly and consolidation occurred often enough to constitute part of the "regular course" of ABB Nuclear's business. Disassembly and disposition are equally part of that business (as we discuss further in 6, below).

The Director's regulations provide examples of what *would* be income arising from outside the regular course of business. Some involve assets with multiple purposes, either concurrent or consecutive. Among them:

> 4. Example: The taxpayer operates a multistate chain of men's clothing stores. The taxpayer invests in a twenty (20)-story office building and uses the street floor as one (1) of its retail stores and the second floor for its general corporate headquarters. The remaining eighteen (18) floors are leased to others. The rental of the eighteen (18) floors is not incidental to but rather is separate from the operation of the taxpayer's trade or business. The net rental income is not business income of the clothing store trade or business. Therefore, the net rental income is nonbusiness income.

12 CSR 10-2.075(5)(A). As this and others of the Director's examples show, income is divided between "business" – arising from activities in the business actually operated by the taxpayer – and "nonbusiness" – income arising from assets after they are removed from the taxpayer's business. The distinction is similar to the one made between operations and investment in *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S.

768, 787 (1992). Is the business from which the income arises one that the taxpayer operates? Or merely one in which the taxpayer has an investment, where the result depends on someone else's decisions and effort?

In this instance, not just the creation and operation but also the consolidation and, ultimately, disposition of ABB Nuclear's assets was well within the operational realm. The proceeds of that sale are thus "business income" subject to apportionment.

5. Applying the "functional" test.

Even if the proceeds did not qualify as "business income" under the first test in Art. IV § 1(1), the "transactional" test, they would qualify under the second, the "functional" test. The Pennsylvania Supreme Court explained that test: "Income meets the functional test if the gain arises from the sale of an asset which produced business income while it was owned by the taxpayer." *Laurel Pipe Line Co. v. Commonwealth*, 642 A.2d 472, 475 (Pa. 1994). The inquiry goes to the use or function of the assets being sold: was the property, or were the assets "integral parts of the taxpayer's regular trade or business operations"? Art. IV § 1(1).

Here again, we could look to the dictionary for the meaning of the terms. Thus "integral" means "of, relating to, or serving to form a whole." WEBSTER'S, p. 1173. That word itself appears in the definition of "part": "an essential element or integral element of something." *Id*. at 1645. But such inquiry seems entirely unnecessary, for no AHC finding could support an argument that what ABB Nuclear's assets where not used as an "integral part" of its "regular trade or business." The record before the AHC, sketchy as

it may be, can support no finding other than the obvious one: that ABB Nuclear's assets were an "integral part" of ABB Nuclear's operations, and thus that their sale produced "business income" under the "functional" test.

6. A "liquidation" exemption.

The AHC held that the sale of ABB Nuclear was a sort of liquidation, and, in essence, that such sales are always outside the "regular course of business," presumably regardless of whether Art. IV § 1(1) provides one test or two. Of course, the AHC found no Missouri authority to support that conclusion. And, again, it merely brushed past the question of what ABB's business is or was, jumping directly to a holding that the sale, disposition, or liquidation of a complete subsidiary is necessarily outside the scope of "regular" business. To fill the dearth of binding authority, the AHC looked to decisions in other states. But those decisions should not persuade this Court.

First, those decisions, like that of the AHC, largely ignore the role a sale plays in the continuing, "unitary" business of a family of companies. The best example is *The May Department Stores Company v. Indiana Department of State Revenue*, 749 N.E. 2d 651 (Ind. Tax Ct. 2001). There the tax court addressed the sale by The May Company, as "successor in merger with Associated Dry Goods Company," of "assets comprising Joseph Horne Co., a division of Associated." *Id*. at 653. The court found that Associated (and thus May) was engaged, and continued to be engaged, "in the business of department store retailing" – the same business as Horne Co. *Id*. at 665. The court nonetheless held that the proceeds from the sale of a single division was not "business income" because the

"*disposition* of Horne's assets was neither a necessary nor an essential part of Associated's department store retailing business operations." *Id.* It did so despite the fact that the sale was essential to May Company's purchase of Associated. In other words, the Indiana court parsed "regular course of business" so narrowly that a sale that is essential to the expansion of an ongoing business by acquisition falls outside the scope of the regular course of that business.

That conclusion makes little sense. Companies regularly buy and sell operations in an effort to focus and refocus on portions that will more profitably interact. The sale of ABB Nuclear was part of ABB's effort to move its "business portfolio towards providing knowledge and service solutions" and to "focus on activities with higher expected growth and synergy potential with other ABB businesses." ABB Annual Report 1999, Exhibit 5, at 2-3. It is illogical to exclude from the "regular course of business" the kind of refocusing that successful companies engage in every day.

And the Indiana decision cannot be easily reconciled with decisions such as *Texaco-Cities Service Co. v. McGaw*, 695 N.E.2d 481 (Ill. App. 1998), discussed in another of the decisions the AHC relies upon, *Lenox, Inc. v. Tolson*, 548 S.E.2d 513, 516 (N.C. 2001). In *Texaco-Cities*, as in *May Company*, the corporate family continued to operate similar businesses – and, in fact, it "reinvested the proceeds" of the sale in those businesses. 695 N.E.2d at 487. Such a decision requires, of course, what is missing from the record here: evidence sufficient to determine that the family of companies is no longer in the business of providing technology and services in the power sector – albeit

outside the nuclear realm.

The *Texaco-Cities* and *Lenox* decisions also highlight something else that is missing here. In language quoted from *Texaco-Cities* by the court in *Lenox*, the Illinois court in turn addressed a decision that the AHC ignored, *Laurel Pipe Line Co. v. Pennsylvania*, 642 A.2d 472 (Pa. 1994). In *Laurel*, the Pennsylvania court insisted that a decision regarding whether the liquidation of a business fell outside the "regular course" of business required a look at "the totality of the circumstances surrounding the sale." 642 A.2d at 576-77. One of the most significant "circumstances" in *Laurel* was "the fact that the sales proceeds were distributed to the shareholders rather than being used to acquire assets or generate income for use in future business operations." 695 N.E.2d at 486-76, citing *Laurel*, 642 A.2d at 476-77. In *Lenox* – "as in *McVean* [*& Barlow, Inc. v. New Mexico Bureau of Revenue*, 543 P.2d 489 (N.M. Ct. App. 1975)] and *Laurel Pipe Line*, the transaction [was] a liquidation in cessation of business." 548 S.E.2d at 668. "The taxpayer distributed the entire after-tax net proceeds to its shareholders and none of the proceeds were used to generate income or acquire assets for use in future business operations." *Id.*

The distribution of proceeds to shareholders demonstrates that a sale is truly a cessation of business, rather than merely a refocusing. Such a demonstration is a key element not just in *Lenox*, but in other cases the AHC cites. In *American States Ins. Co. v. Hamer*, 816 N.E.2d 659, 660 (Ill. App. 2004), the question was tax treatment for the proceeds from a sale "resulting in a cash distribution to all shareholders." In two cases,

the entire company was liquidated, again with the proceeds distributed to the shareholders. *Kemppel v. Zaino*, 746 N.E.2d 1073, 1076 (Ohio 2001); *Blessing/White, Inc. v. Zehnder*, 768 N.E. 2d 332, 335 (Ill. App. 2002). And another involves the sale of a company's "only asset." *Uniroyal Tire Co. v. State Dep't of Revenue*, 779 S.2d 227, 228 (Ala. 2000).

The AHC found – correctly, based on the record before it – that the proceeds of the sale of ABB Nuclear were paid to its corporate parent, A4 ¶ 11 – *not* that the proceeds flowed through the complex ABB corporate structure and were eventually distributed to its individual shareholders. What little evidence the record contains suggests not that the sale was a cessation or dissolution, but that it was merely a normal part of the regular focusing efforts of a successful multinational business.

The AHC lacked a record on which to find that the sale was the kind of transaction at issue in *Lenox*, *Kemppel*, *Blessing/White*, and other cases that it cited. It was without support in Missouri law for the creation of a "liquidation" exemption from "business income" – especially one so broad as to exclude from "regular business" transactions that dispose of some portion of a corporate family's business and in turn produce revenue used to build up another portion.

CONCLUSION

For the reasons stated above, the Court should reverse the decision of the Administrative Hearing Commission and affirm the decision of the Director of Revenue.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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CERTIFICATION OF COMPLIANCE

The undersigned hereby certifies that the foregoing brief complies with the limitations contained in Rule No. 84.06(b), and that the brief contains 7,941 words.

The undersigned further certifies that the labeled disk simultaneously filed with the hard copies of the brief has been scanned for viruses and is virus-free.

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James R. Layton
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IN THE
SUPREME COURT OF MISSOURI

SC87811

ABB C-E NUCLEAR POWER INC.,

Respondent,

v.

DIRECTOR OF REVENUE,

Appellant.

From the Administrative Hearing Commission of Missouri
The Honorable Karen A. Winn, Commissioner

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